

LifeWays

paths for personal growth

Jackson, Michigan

**Financial Statements
And Single Audit**

**For The Year Ended
September 30, 2004**

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type [] City [] Township [] Village [x] Other		Local Government Name LifeWays		County Jackson
Audit Date 9/30/04	Opinion Date 12/17/04	Date Accountant Report Submitted to State: 2/17/05		

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- | | | | | |
|--------------------------|-----|-------------------------------------|----|---|
| <input type="checkbox"/> | Yes | <input checked="" type="checkbox"/> | No | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> | Yes | <input checked="" type="checkbox"/> | No | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> | Yes | <input checked="" type="checkbox"/> | No | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> | Yes | <input checked="" type="checkbox"/> | No | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> | Yes | <input checked="" type="checkbox"/> | No | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]). |
| <input type="checkbox"/> | Yes | <input checked="" type="checkbox"/> | No | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> | Yes | <input checked="" type="checkbox"/> | No | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> | Yes | <input checked="" type="checkbox"/> | No | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> | Yes | <input checked="" type="checkbox"/> | No | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	X		
Reports on individual federal financial assistance programs (program audits).			X
Single Audit Reports (ASLGU).	X		

Certified Public Accountant (Firm Name) REHMANN ROBSON GERALD J. DESLOOVER, CPA			
Street Address 5800 GRATIOT, PO BOX 2025	City SAGINAW	State MI	Zip 48605
Accountant Signature <i>Rehmann Robson</i>			

LifeWays

Table of Contents

	<u>PAGE</u>
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-7
Basic Financial Statements for the Year Ended September 30, 2004	
Government-wide/Fund Financial Statements:	
Statement of Net Assets – Proprietary Funds	8
Statement of Activities and Proprietary Funds	
Revenue, Expenses, and Changes in Fund Net Assets	9
Statement of Cash Flows – Proprietary Funds	10-11
Notes to Financial Statements	12-21
GASB Required Supplementary Information	
GASB Statement 25 – Employee Retirement System:	
Schedule of Funding Progress	22
Schedule of Employer Contributions	22
Supplementary Information	
Combining Statement of Net Assets – Internal Service Funds	23
Combining Statement of Revenue, Expenses and Changes in Fund Net Assets – Internal Service Funds	24
Combining Statement of Cash Flows – Internal Service Funds	25
Single Audit Section	
Schedule of Expenditures of Federal Awards	26
Notes to Schedule of Expenditures of Federal Awards	27
Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	28-29
Independent Auditors' Report on Compliance With Requirements Applicable to a Major Program and Internal Control Over Compliance in Accordance With OMB Circular A-133	30-31
Schedule of Findings and Questioned Costs	32-33

* * * * *



REHMANN ROBSON

Certified Public Accountants

A member of THE REHMANN GROUP

An Independent Member of Baker Tilly International

INDEPENDENT AUDITORS' REPORT

December 17, 2004

The Board of Directors
LifeWays
Jackson, Michigan

We have audited the accompanying financial statements of the business-type activities, the major fund, and the aggregate remaining fund information of *LifeWays* as of and for the year ended September 30, 2004, which collectively comprise LifeWays' basic financial statements as listed in the table of contents. These financial statements are the responsibility of LifeWays' management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities, the major fund, and the aggregate remaining fund information of LifeWays as of September 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2004, on our consideration of LifeWays' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis and GASB Statement 25 supplementary information listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise LifeWays' basic financial statements. The accompanying schedule of expenditures of federal awards, as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the combining nonmajor fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Rehmann Lohman

MANAGEMENT'S DISCUSSION AND ANALYSIS

LifeWays

Management's Discussion and Analysis

As management and administrators of LifeWays, we offer readers of LifeWays' financial statements this narrative overview and analysis of the financial activities of LifeWays for the fiscal year ended September 30, 2004.

Overview of the Financial Statements

- Total assets of LifeWays amounted to \$12,024,785 and total liabilities amounted to \$5,816,721 on September 30, 2004.
- LifeWays total net assets decreased by \$331,884 during the current year.
- As of the close of the current fiscal year, LifeWays' reported ending net assets of \$6,208,064. Approximately 55% of this balance, or \$3,416,350 is *available for spending* at LifeWays' discretion (*Operating Fund unrestricted net assets*). An additional 12%, or \$764,736 is invested in capital assets, net of related debt. The remaining 33%, or \$2,026,978, is to be held as a reserve against potential liabilities relative to and as allowed by its contract with the Michigan Department of Community Health (MDCH).
- In addition, LifeWays has reported deferred Medicaid savings (\$1,431,163), which are limited for use in the next fiscal year and must be used consistent with a plan approved by the Michigan Department of Community Health.

This discussion and analysis are intended to serve as an introduction to LifeWays' basic financial statements. LifeWays' basic financial statements are comprised of two components:

- 1) Government-wide/fund financial statements
- 2) Notes to the financial statements.

This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide/Fund Financial Statements. As permitted by GASB Statement No. 34, LifeWays uses an alternative approach reserved for single program governments to present combined government-wide and fund financial statements. These financial statements are designed to provide readers with a broad overview of LifeWays' finances, in a manner similar to a private-sector business. This is done by reporting LifeWays' assets and liabilities using the full accrual method of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

The *Statement of Net Assets* presents information on all of LifeWays' assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of LifeWays is improving or deteriorating.

The *Statement of Activities and Proprietary Fund Revenue, Expenses and Changes in Fund Net Assets* presents information showing how LifeWays' revenue and expenses changed during the most recent fiscal year. All changes in revenue and expenses are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods. In addition, this statement discloses *non-cash* expenditures of depreciation and amortization, which affect the ending book value of capital assets.

The *Statement of Cash Flows* presents information about the source and usage of cash and cash equivalents and divides the information reported into three classifications: operating, financing, and investing. LifeWays' operations generate and use cash in the normal flow of activity: the collection of revenues and payments to contractors plus the non-cash activity add-backs such as depreciation. Financing activities include borrowing and repayment of long-term debt and purchase of equipment/group homes. Investing includes such items as investment of cash and other long-term assets.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide/fund financial statements. The accompanying notes are an integral part of the financial statements and must be reviewed in conjunction with the information reported on the financial statements to provide a full understanding of LifeWays' financial situation.

Government-wide Financial Analysis

By far the largest portion of LifeWays' total assets (\$10,019,172 or 83%) reflects its cash and cash equivalents. These assets primarily constitute local resources. A portion of the cash balance (\$2,048,902) is held as Risk Reserve against potential liabilities relative to and as allowed by its contract with the Michigan Department of Community Health (MDCH).

The second largest portion of LifeWays' total assets (\$1,589,736 or 13%) reflects its investment in capital assets (e.g., group homes, equipment, and furniture). LifeWays uses some of the capital assets (group homes) to provide services to the consumers it serves; consequently, these assets are *not* available for future spending and are considered fixed.

LifeWays' Total Assets & Net Assets

	<u>2004</u>	<u>2003</u>
Current and other assets	\$ 10,435,049	\$ 9,134,399
Capital assets, net	<u>1,589,736</u>	<u>1,801,011</u>
Total assets	<u>12,024,785</u>	<u>10,935,410</u>
Long-term liabilities outstanding	825,000	850,000
Other liabilities	<u>4,991,721</u>	<u>3,545,462</u>
Total liabilities	<u>5,816,721</u>	<u>4,395,462</u>
Net assets:		
Invested in capital assets, net of related debt	764,736	951,011
Restricted	2,026,978	2,010,339
Unrestricted	<u>3,416,350</u>	<u>3,578,598</u>
Total net assets	<u>\$ 6,208,064</u>	<u>\$ 6,539,948</u>

LifeWays' net assets decreased by \$331,884 during the current fiscal year. This is largely due to an accrual for a 2001-2002 liability for the MI Choice HCBS E/D Program of \$332,375. The liability is due to a loss of judgment at administrative hearing and is currently being appealed at circuit court, and if reversed, the accrual will be removed.

LifeWays' Changes in Net Assets

	<u>2004</u>	<u>2003</u>
Operating revenue:		
MDCH Contract	\$ 31,285,770	\$ 29,138,431
Operating grants and contributions	1,381,634	1,225,286
Charges for services and other local revenue	<u>1,297,040</u>	<u>950,003</u>
	<u>33,964,444</u>	<u>31,313,720</u>
Operating expenses:		
Board administration	4,160,497	3,729,074
Mental health services	29,580,159	26,689,444
Substance abuse	422,493	399,175
Depreciation and amortization	<u>223,418</u>	<u>218,287</u>
	<u>34,386,567</u>	<u>31,035,980</u>
Operating income (loss)	(422,123)	277,740
Non-operating revenue (expense)		
Interest income	138,450	102,691
Interest expense	<u>(48,211)</u>	<u>(49,390)</u>
	<u>90,239</u>	<u>53,301</u>
Net income (loss)	(331,884)	331,041
Net assets, beginning of year	<u>6,539,948</u>	<u>6,208,907</u>
Net assets, end of year	<u>\$ 6,208,064</u>	<u>\$ 6,539,948</u>

Financial Analysis of LifeWays' Funds

As noted earlier, LifeWays uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Operating Fund LifeWays accounts for its primary operations in an enterprise fund which is accounted for on the same basis of accounting as the government-wide financial statements. Accordingly, a separate analysis is not included herein.

Internal Service Funds The focus of LifeWays' internal service funds is used to account for assets held as a reserve against potential liabilities relative to and allowed by its contract with the Michigan Department of Community Health (MDCH). LifeWays' risk management plan has been reviewed and approved by MDCH.

At the end of the current fiscal year, LifeWays' internal service funds had combined net assets of \$2,026,978, an increase of \$16,639 in comparison with the prior year. The total amount is reserved to be used against possible operating expenses in excess of contract revenues within a specified risk corridor and consistent with LifeWays' risk management plan. During the current fiscal year, LifeWays' operating expenses were in excess of contract revenues specified under the State General Fund risk corridor. General Fund Risk Financing totaled \$13,701.

Explanation of Adjustments The Statement of Activities includes an adjustment to the fund financial statements of \$2,525 to eliminate the effect of interfund transactions. This is reflected as a reduction to both revenue and expense. In addition, interfund transfers related to the use of risk reserve internal service funds were eliminated in the amount of \$13,701.

Capital Asset and Debt Administration

Capital assets. LifeWays' investment in capital assets for its activities as of September 30, 2004, amounted to \$1,589,736 (net of accumulated depreciation of \$984,406). This investment in capital assets includes group homes, leasehold improvements, and equipment. Capital assets increased by \$11,193 during the current fiscal year.

The only capital asset event during the current fiscal year was as follows:

- \$11,193 for leasehold improvements to the New Passages Area

Accumulated depreciation at September 30, 2004 amounted to \$984,406 and included current year depreciation expense of \$222,468.

LifeWays' Capital Assets (Net of depreciation) September 30, 2004

Computer equipment	\$ 191,948
Furnishings and other equipment	8,304
Leasehold improvements	592,114
Group homes	<u>797,370</u>
Total	<u>\$ 1,589,736</u>

Long-term debt. At the end of the current fiscal year, LifeWays had general obligation bond debt outstanding of \$825,000. The current portion of bonded debt is \$25,000. These bonds were issued to finance the acquisition of five group homes for providing residential services to LifeWays' consumers.

Factors Bearing on LifeWays' Future

The following factors were considered in preparing LifeWays' budget for the 2004-05 fiscal year:

- Potential Executive Order cuts issued by the Governor to address unplanned state budget shortfalls.
- Increases in known and estimated costs – namely, energy, health insurance, workers' compensation insurance and salary increases.
- An increasing trend in Medicaid-eligible consumers and the uninsured population related to increased unemployment and a sluggish economy.
- Potential building purchase.
- The final report of a required State audit, which could result in a financial liability, and threat to Internal Service Fund holdings.
- Potential Federal and State Medicaid cuts either through funding or service eligibility.
- 2005/2006 Rate rebasing by the State based on encounter data or actuarial analysis.
- New community service initiatives including:
 - ✓ Drug treatment courts
 - ✓ Mental health courts
 - ✓ Prisoner re-entry program
 - ✓ Service integration initiatives

Requests for Information

This financial report is designed to provide a general overview of LifeWays' finances for all those with an interest in LifeWays' finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Lynn Guernsey, CFO, LifeWays 1200 N. West Ave. Jackson, Michigan 49202.

BASIC FINANCIAL STATEMENTS

LifeWays
Statement of Net Assets
Proprietary Funds
September 30, 2004

	<u>Enterprise Operating Fund</u>	<u>Internal Service</u>	<u>Total Business-type Activities</u>
Assets			
Cash and cash equivalents	\$ 7,970,270	\$ 2,048,902	\$ 10,019,172
Receivables:			
Fees, net of allowance for doubtful accounts of \$24,000	28,628	-	28,628
Due from Michigan Department of Community Health	106,164	-	106,164
Other	211,918	-	211,918
Prepaid items	54,917	-	54,917
Capital assets, net	1,589,736	-	1,589,736
Unamortized bond issuance costs	14,250	-	14,250
	<u>9,975,883</u>	<u>2,048,902</u>	<u>12,024,785</u>
Total assets			
Liabilities			
Accounts payable	1,649,090	-	1,649,090
Due to Michigan Department of Community Health	386,733	-	386,733
Accrued liabilities	1,137,482	-	1,137,482
Claims incurred but not reported	365,329	-	365,329
Deferred revenue	1,431,163	21,924	1,453,087
Long-term debt:			
Due within one year	25,000	-	25,000
Due in more than one year	800,000	-	800,000
	<u>5,794,797</u>	<u>21,924</u>	<u>5,816,721</u>
Total liabilities			
Net assets			
Invested in capital assets, net of related debt	764,736	-	764,736
Restricted for contract losses	-	2,026,978	2,026,978
Unrestricted	3,416,350	-	3,416,350
	<u>\$ 4,181,086</u>	<u>\$ 2,026,978</u>	<u>\$ 6,208,064</u>
Total net assets			

The accompanying notes are an integral part of these financial statements.

LifeWays
Statement of Activities and
Proprietary Fund Revenue, Expenses, and Changes in Fund Net Assets
For the Year Ended September 30, 2004

	<u>Enterprise Operating Fund</u>	<u>Internal Service</u>	<u>Adjustments</u>	<u>Total Business-type Activities</u>
Operating revenue				
Medicaid capitation	\$ 26,568,127	\$ -	\$ -	\$ 26,568,127
State general fund indigent	4,717,643	-	-	4,717,643
Earned revenues, grants and federal programs	1,001,460	-	-	1,001,460
Substance abuse	380,174	-	-	380,174
Charges for services	-	2,525	(2,525)	-
Local revenue:				
County appropriations	94,135	-	-	94,135
Rental revenue	581,826	-	-	581,826
First party	91,696	-	-	91,696
Third party	469,630	-	-	469,630
Other local revenue	59,753	-	-	59,753
Total operating revenue	<u>33,964,444</u>	<u>2,525</u>	<u>(2,525)</u>	<u>33,964,444</u>
Operating expenses				
Board administration	4,160,497	-	-	4,160,497
Mental health services	29,580,159	-	-	29,580,159
Substance abuse	425,018	-	(2,525)	422,493
Depreciation and amortization	223,418	-	-	223,418
Total operating expenses	<u>34,389,092</u>	<u>-</u>	<u>(2,525)</u>	<u>34,386,567</u>
Operating income (loss)	<u>(424,648)</u>	<u>2,525</u>	<u>-</u>	<u>(422,123)</u>
Non-operating revenue (expense)				
Interest income	110,635	27,815	-	138,450
Interest expense	(48,211)	-	-	(48,211)
Total non-operating revenue	<u>62,424</u>	<u>27,815</u>	<u>-</u>	<u>90,239</u>
Net income (loss) before transfers	<u>(362,224)</u>	<u>30,340</u>	<u>-</u>	<u>(331,884)</u>
Transfers				
Transfers in	13,701	-	(13,701)	-
Transfers out	-	(13,701)	13,701	-
Transfers	<u>13,701</u>	<u>(13,701)</u>	<u>-</u>	<u>-</u>
Change in net assets	<u>(348,523)</u>	<u>16,639</u>	<u>-</u>	<u>(331,884)</u>
Net assets, beginning of year	<u>4,529,609</u>	<u>2,010,339</u>	<u>-</u>	<u>6,539,948</u>
Net assets, end of year	<u>\$ 4,181,086</u>	<u>\$ 2,026,978</u>	<u>\$ -</u>	<u>\$ 6,208,064</u>

The accompanying notes are an integral part of these financial statements.

LifeWays
Statement of Cash Flows
Proprietary Funds
For the Year Ended September 30, 2004

	<u>Enterprise Operating Fund</u>	<u>Internal Service</u>
Cash flows from operating activities		
Cash received from customers and others	\$ 34,672,996	\$ 10,278
Cash payments to employees	(2,366,026)	-
Cash payments to suppliers for goods and services	(30,465,826)	-
Net cash provided by operating activities	<u>1,841,144</u>	<u>10,278</u>
Cash flows from capital and related financing activities		
Principal paid on bonds	(25,000)	-
Interest paid on bonds	(48,211)	-
Purchase of capital assets	(11,193)	-
Net cash used in capital and related financing activities	<u>(84,404)</u>	<u>-</u>
Cash flows from non-capital financing activities		
Transfers in	13,701	-
Transfers out	-	(13,701)
Net cash provided by (used in) non-capital financing activities	<u>13,701</u>	<u>(13,701)</u>
Cash flows from investing activities		
Interest received	<u>110,635</u>	<u>27,815</u>
Net increase in cash and cash equivalents	1,881,076	24,392
Cash and cash equivalents, beginning of year	<u>6,089,194</u>	<u>2,024,510</u>
Cash and cash equivalents, end of year	<u>\$ 7,970,270</u>	<u>\$ 2,048,902</u>

continued...

LifeWays
Statement of Cash Flows
Proprietary Funds (Concluded)
For the Year Ended September 30, 2004

	<u>Enterprise Operating Fund</u>	<u>Internal Service</u>
Reconciliation of operating income (loss) to net cash provided by operating activities		
Operating income	\$ (424,648)	\$ 2,525
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation and amortization	223,418	-
Changes in assets and liabilities:		
Fees receivable	10,786	-
Due from Michigan Department of Community Health	179,409	-
Other receivables	344,945	-
Prepaid items	68,728	-
Accounts payable	544,091	-
Due to Michigan Department of Community Health	264,095	-
Accrued liabilities	343,659	-
Claims incurred but not reported	113,249	-
Deferred revenue	173,412	7,753
Net cash provided by operating activities	<u>\$ 1,841,144</u>	<u>\$ 10,278</u>

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

LifeWays

Notes to Financial Statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of **LifeWays**, a Community Mental Health Authority established under Section 205 of the Michigan Mental Health Code, have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Government Accounting Standards Board (GASB) is the accepted standards-setting body for establishing governmental accounting and financial reporting principles. The more significant of LifeWays accounting policies are described below.

A. Reporting Entity

As indicated above, LifeWays is a Community Mental Health Authority serving the mental health needs of Jackson and Hillsdale County residents. Its Board of Directors is appointed by the County Commissions of Jackson and Hillsdale Counties.

B. Government-wide and Fund Financial Statements

As permitted by GASB Statement No. 34, LifeWays uses an alternative approach reserved for single program governments to present combined government-wide and fund financial statements by using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column. Accordingly, this is presented in the Statement of Net Assets – Proprietary Funds and the Statement of Activities and Proprietary Fund Revenues, Expenses and Changes in Fund Net Assets. LifeWays' only major fund is reported in a separate column in the aforementioned financial statements.

The operations of LifeWays are accounted for as an Enterprise Fund (a proprietary fund) which is designed to be self-supporting. Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the cost of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The Risk Reserve Funds (which are both internal service funds, a proprietary fund type) are used to account for assets held as a reserve against potential liabilities relative to and as allowed by its contract with the Michigan Department of Community Health (MDCH). Pursuant to these contractual provisions, LifeWays risk management plan has been reviewed and approved by MDCH. Separate risk reserves are maintained for mental health and substance abuse services.

LifeWays

Notes to Financial Statements

C. Measurement focus, basis of accounting, and financial statement presentation

The government-wide and proprietary fund financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The enterprise fund is LifeWays' primary operating fund, and only major fund. It accounts for all financial resources of the government, except those required to be accounted for in another fund.

Private sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the *option* of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to the same limitation. The government has elected not to follow subsequent private-sector guidance.

Proprietary funds distinguish *operating* revenues and expenses from *non-operating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of LifeWays' operating fund are contract revenues from MDCH and first and third party billings. Operating revenues of the internal service funds are primarily comprised of charges to other funds and governmental entities for risk financing. Operating expenses include the cost of providing mental health and substance abuse services. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

D. Assets, liabilities and equity

1. Deposits

Cash and cash equivalents are considered to be cash on hand and amounts in demand deposit accounts.

State statutes authorize units of local government to deposit in the accounts of federally insured banks, credit unions, and savings and loan associations, and to invest in obligations of the U.S. Treasury, certain commercial paper, repurchase agreements, bankers acceptances, and mutual funds composed of otherwise legal investments.

LifeWays

Notes to Financial Statements

2. Receivables and Payables

Fee accounts receivable are shown net of an allowance for uncollectibles, which is based on management's estimate using collection history trends.

3. Prepayments

Payments made to vendors for services that will benefit periods beyond September 30, 2004, are recorded as "prepaid items" in the accompanying statement of net assets.

4. Capital Assets

Capital assets are capitalized and reported in the operating fund, net of accumulated depreciation. Capital assets are depreciated on the straight-line basis over the estimated useful lives of those assets, which range from five to forty years. All purchased capital assets are recorded at cost where historical records are available and at estimated historical costs where no historical records exist. Donated capital assets, if any, are valued at their estimated fair market value on the date received.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Improvements are capitalized.

5. Compensated Absences

Vacation, sick leave and personal days cannot be carried over, and are not accrued in the accompanying financial statements.

6. Deferred Revenue

Deferred revenue represents that portion of the current-year MDCH contract amount that may be carried-over to and expended in subsequent fiscal years. Such carryover is generally limited to five percent of the MDCH contract amount.

Medicaid Savings are considered local funds under the contract with MDCH, and may be spent over a period of several years in accordance with a Medicaid Reinvestment Strategy. State General Funds carried over must generally be spent in the following year.

LifeWays

Notes to Financial Statements

7. Risk Management

LifeWays is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and injuries to employees. During the year ended September 30, 2004, the entity carried commercial insurance to cover all risks of losses, except for any potential operating shortfalls under the terms of its contract with MDCH, which are covered by the Risk Reserve Internal Service Funds. LifeWays had no settled claims resulting from these risks that exceeded their commercial coverage in any of the past three fiscal years.

2. DETAILED NOTES ON ALL FUNDS

A. Deposits

At year end, the carrying amount and bank balance of LifeWays' deposits were as follows:

	<u>Carrying Amount</u>	<u>Bank Balance</u>
Demand accounts	\$ 21,714	\$ 217,031
Imprest cash	400	-
Jackson County Treasurer	<u>9,997,058</u>	<u>9,997,059</u>
	<u>\$ 10,019,172</u>	<u>\$ 10,214,090</u>

LifeWays' demand accounts are comprised of checking accounts with local banks, and are insured by the FDIC in the amount of \$100,500. The remaining balance of \$116,531 was uninsured and uncollateralized.

As an Authority, LifeWays is authorized to deposit or invest in any accounts or institutions as permitted by State statutes. However, because of favorable terms, LifeWays has chosen to participate in Jackson County's investment pool, which is managed by the Jackson County Treasurer. These funds are deposited in the Treasurer's pooled accounts, and are deposited by and in the name of the Jackson County Treasurer. Other County funds are also deposited in those accounts and, as such, because of the complexities of FDIC Regulation #330.8, it is not possible to readily determine the amount of insurance that would be allocated to LifeWays' deposits.

LifeWays

Notes to Financial Statements

B. Due From/To Michigan Department of Community Health

For the year ended September 30, 2004, the operations of LifeWays were conducted under the terms and conditions of its contract with the MDCH.

The \$106,164 due from the MDCH represents amounts due for behavioral health services and other services provided by LifeWays. The receivable balance is comprised wholly of federal and state grants.

The \$386,733 due to the MDCH represents LifeWays' estimate of amounts payable to the State of Michigan for institutional care services provided by State institutions, certain amounts payable under the managed specialty supports and services contract, and the current year estimated cost settlement payable for the current year.

C. Capital Assets

Following is a summary of capital assets activity for the year ended September 30, 2004:

	<u>Beginning of Year</u>	<u>Additions</u>	<u>Deletions</u>	<u>End of Year</u>
Cost				
Computer equipment	\$ 780,453	\$ -	\$ -	\$ 780,453
Furnishings and other equipment	35,727	-	-	35,727
Leasehold improvements	831,754	11,193	-	842,947
Group homes	<u>915,015</u>	<u>-</u>	<u>-</u>	<u>915,015</u>
Total	<u>2,562,949</u>	<u>11,193</u>	<u>-</u>	<u>2,574,142</u>
Accumulated depreciation				
Computer equipment	430,678	157,827	-	588,505
Furnishings and other equipment	23,928	3,495	-	27,423
Leasehold improvements	215,831	35,002	-	250,833
Group homes	<u>91,501</u>	<u>26,144</u>	<u>-</u>	<u>117,645</u>
Total	<u>761,938</u>	<u>222,468</u>	<u>-</u>	<u>984,406</u>
Capital assets, net	<u>\$1,801,011</u>	<u>\$ (211,275)</u>	<u>\$ -</u>	<u>\$ 1,589,736</u>

LifeWays

Notes to Financial Statements

D. Long-term Debt

General Obligation Bonds. LifeWays uses general obligation bonds to provide funds for the acquisition and construction of major capital facilities. These bonds generally are issued as 20-year serial bonds with varying amounts of principal maturing each year. General obligation bonds currently outstanding are as follows:

<u>Purpose</u>	<u>Interest Rates</u>	<u>Balance, Beginning of Year</u>	<u>Deletions</u>	<u>Balance, End of Year</u>	<u>Amount Due Within One Year</u>
Series 1999 A Jackson County Building Authority Bonds (lease payable)	4.0 - 6.0%	<u>\$ 850,000</u>	<u>\$ 25,000</u>	<u>\$ 825,000</u>	<u>\$ 25,000</u>

The Jackson County Building Authority lease payable is equal to the aggregate outstanding principal and interest payments due on bonds issued by the Jackson County Building Authority, that pledge the full faith and credit of the government. Those bonds were issued to finance the acquisition of five group homes for providing residential services.

The requirements to amortize all debt outstanding at September 30, 2004, is as follows:

<u>Fiscal Year Ending</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 25,000	\$ 46,800	\$ 71,800
2006	25,000	45,550	70,550
2007	50,000	44,275	94,275
2008	50,000	41,675	91,675
2009	50,000	39,025	89,025
2010-2014	250,000	154,350	404,350
2015-2019	<u>375,000</u>	<u>67,350</u>	<u>442,350</u>
Total	<u>\$ 825,000</u>	<u>\$ 439,025</u>	<u>\$ 1,264,025</u>

LifeWays

Notes to Financial Statements

E. Risk Reserve Fund Net Assets

At September 30, 2004, the net assets of the Risk Reserve Internal Service Funds were comprised of the following:

	<u>Mental Health</u>	<u>Substance Abuse</u>	<u>Total</u>
Beginning balance	\$1,980,381	\$ 29,958	\$2,010,339
Additions	27,413	2,927	30,340
Deletions	<u>(13,701)</u>	<u>-</u>	<u>(13,701)</u>
Ending balance	<u>\$1,994,093</u>	<u>\$ 32,885</u>	<u>\$2,026,978</u>

Mental Health Risk Reserve

Under the terms of its managed specialty supports and services contract with MDCH, LifeWays is at risk for its operating expenses in excess of contract revenues within a specified risk corridor. In accordance with the contract, LifeWays is authorized and required to retain these funds until needed to offset actual operating losses within the risk corridor. LifeWays maximum risk exposure under the contract with MDCH is \$2,406,725, based on current funding levels (\$2,004,014 Medicaid, \$346,523 General Fund, and \$56,188 Local).

During the year, the Mental Health Risk Reserve Internal Service Fund earned interest of \$27,413, which was retained in the fund inasmuch as total risk reserves are less than LifeWays maximum risk exposure. In addition, the Mental Health Risk Reserve Internal Service Fund transferred \$13,701 to the operating fund to cover LifeWays risk obligation for the current year.

Substance Abuse Risk Reserve

Net assets in the substance abuse risk reserve are held on behalf of the Mid-South Substance Abuse Coordinating Agency. Contributions are made to the reserve by Mid-South as funds permit, and LifeWays distributes funds to Mid-South upon request.

LifeWays

Notes to Financial Statements

F. Retirement Plan

LifeWays has a single-employer defined benefit pension plan (the "LifeWays Pension Plan") for employees of LifeWays, which provides retirement, death and disability benefits covering substantially all of LifeWays' full-time employees. Membership of the Plan consisted of the following at October 1, 2003, the date of the latest actuarial valuation:

Retirees and beneficiaries receiving benefits	9
Terminated plan members entitled to but not yet receiving benefits	54
Active plan members	<u>42</u>
	<u><u>105</u></u>

The Plan is non-contributory for employees; by Board Resolution, LifeWays is required to contribute at an actuarially determined rate all amounts necessary to provide assets sufficient to pay for member benefits. LifeWays' contribution to the Plan for the year ended September 30, 2004, represents 15.4% of the annual covered payroll.

The Plan is administered by a third-party insurance company. Administrative costs of the Plan are financed through investment earnings.

Plan provisions are established and amended under the authority of LifeWays' Board. Contribution requirements are established and amended subject to Board approval.

The Plan's annual retirement benefits cost and net retirement benefits obligation for the current year were as follows:

Annual required contribution / retirement benefit cost	\$319,537
Contribution made	<u>(319,537)</u>
Increase (decrease) in net retirement benefit obligation	-
Net retirement benefit obligation, beginning of year	<u>-</u>
Net retirement benefit obligation, end of year	<u><u>\$ -</u></u>

The annual required contribution for the current year was determined as part of an actuarial valuation of the Plan as of October 1, 2003, using the aggregate actuarial cost method. The actuarial assumptions included: (a) a rate of return on investments of 7.0%; (b) projected salary increases of 1.5% attributable to inflation; and (c) the assumption that the excess of the present value of benefits over valuation assets is spread over the average working lifetime of plan participants.

LifeWays

Notes to Financial Statements

The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a four-year period. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis over 30 years from April 15, 1992.

Three-Year Trend Information

<u>Year Ending</u>	<u>Annual Retirement Benefit Cost (ARBC)</u>	<u>Percentage of ARBC Contributed</u>	<u>Net Retirement Benefit Obligation</u>
9/30/2002	\$310,429	100.0%	\$ -
9/30/2003	336,528	100.0%	-
9/30/2004	319,537	100.0%	-

GASB Statement 25 required supplementary information is presented after the Notes to Financial Statements section of this report.

G. Claims Incurred But Not Reported

LifeWays estimates the liability for contractual services provided by its contract providers that have been incurred through the end of the fiscal year, including both those claims that have been reported as well as those that have not yet been reported. Changes in the estimated liability are as follows:

Estimated liability, beginning of year	\$ 252,000
Estimated claims incurred	13,681,113
Claim payments	<u>(13,567,784)</u>
Estimated liability, end of year	<u>\$ 365,329</u>

LifeWays

Notes to Financial Statements

H. Contribution to the King Trust Charitable Gift Fund

In 2002, LifeWays made contributions to the King Trust Charitable Gift Fund (the "Fund"), to establish the "LifeWays Foundation" account. While LifeWays may make recommendations regarding the use of the Fund, any contributions made are irrevocable and become assets of the Fund. Since LifeWays is not the trustee of the LifeWays Foundation account, and does not exercise any control over the Fund's assets, no amounts were recorded in these financial statements at year end. The balance in the LifeWays Foundation account at September 30, 2004 was \$6,052.

I. Contingencies and Commitments

Under the terms of various Federal and State grants and regulatory requirements, LifeWays is subject to periodic audits of its agreements. Such audits could lead to questioned costs and/or requests for reimbursement to grantor or regulatory agencies.

As is the case with other entities, LifeWays faces exposure from potential claims and legal proceedings involving environmental and other matters. No such claims or proceedings have been asserted as of September 30, 2004.

**GASB REQUIRED SUPPLEMENTARY
INFORMATION**

LifeWays
GASB Statement 25 Required Supplementary Information
Employee Retirement System

Schedule of Funding Progress

	(1)	(2)	(3)	(4)	(5)	(6)
Actuarial Valuation Date Oct. 1	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age	Unfunded AAL (UAAL) (2-1)	Funded Ratio (1/2)	Covered Payroll	UAAL as a % of Covered Payroll (3/5)
1994	\$ 276,492	\$ 726,308	\$ 449,816	38.1 %	\$ 1,893,667	23.8 %
1995	565,733	1,124,057	558,324	50.3	2,533,691	22.0
1996	891,391	1,846,011	954,620	48.3	2,649,503	36.0
1997	1,382,713	1,814,743	432,030	76.2	2,840,510	15.2
1998	1,445,894	2,222,694	776,800	65.1	2,464,317	31.5
1999	1,809,122	2,380,312	571,190	76.0	2,576,654	22.2
2000	2,236,469	2,793,508	557,039	80.1	2,271,312	24.5
2001	2,157,775	2,349,783	192,008	91.8	2,337,520	8.2
2002	2,214,182	2,708,063	493,881	81.8	1,948,381	25.3
2003	2,775,533	3,617,533	842,000	76.7	1,940,994	43.4

Schedule of Employer Contributions

Fiscal Year Ended Sept. 30	Contribution Rates as Percents of Valuation Payroll	Valuation Payroll	Annual Required Contribution	Annual Actual Contribution	Percentage Contributed
1994	7.2 %	\$ 1,893,667	\$ 136,291	\$ 136,291	100.0 %
1995	8.1	2,533,691	205,170	205,170	100.0
1996	9.9	2,649,503	262,964	262,964	100.0
1997	10.0	2,840,510	283,998	283,998	100.0
1998	9.4	2,464,317	230,891	230,891	100.0
1999	11.8	2,576,654	303,890	303,890	100.0
2000	12.4	2,271,312	280,974	280,974	100.0
2001	10.9	2,337,520	255,090	255,090	100.0
2002	14.4	2,149,106	310,429	310,429	100.0
2003	17.3	1,948,381	336,528	336,528	100.0
2004	16.5	1,940,994	319,537	319,537	100.0

**SUPPLEMENTARY
INFORMATION**

LifeWays
Combining Statement of Net Assets - Internal Service Funds
September 30, 2004

	<u>Mental Health Risk Reserve</u>	<u>Substance Abuse Risk Reserve</u>	<u>Totals</u>
Assets			
Cash and cash equivalents	\$ 1,994,093	\$ 54,809	\$ 2,048,902
Liabilities			
Deferred revenue	<u>-</u>	<u>21,924</u>	<u>21,924</u>
Net assets			
Restricted for contract losses	<u>\$ 1,994,093</u>	<u>\$ 32,885</u>	<u>\$ 2,026,978</u>

LifeWays
Combining Statement of Revenue, Expenses and Changes
in Net Assets - Internal Service Funds
For the Year Ended September 30, 2004

	Mental Health Risk Reserve	Substance Abuse Risk Reserve	Totals
Operating revenue			
Charges for services	\$ -	\$ 2,525	\$ 2,525
Non-operating revenue			
Interest income	27,413	402	27,815
Net income before transfers	27,413	2,927	30,340
Transfers out	(13,701)	-	(13,701)
Change in net assets	13,712	2,927	16,639
Net assets, beginning of year	1,980,381	29,958	2,010,339
Net assets, end of year	<u>\$ 1,994,093</u>	<u>\$ 32,885</u>	<u>\$ 2,026,978</u>

LifeWays
Combining Statement of Cash Flows
Internal Service Funds
For the Year Ended September 30, 2004

	Mental Health Risk Reserve	Substance Abuse Risk Reserve	Totals
Cash flows from operating activities			
Cash received from customers and others	\$ -	\$ 10,278	\$ 10,278
Cash flows from non-capital financing activities			
Transfers out	(13,701)	-	(13,701)
Cash flows from investing activities			
Interest received	<u>27,413</u>	<u>402</u>	<u>27,815</u>
Net increase in cash and cash equivalents	13,712	10,680	24,392
Cash and cash equivalents, beginning of year	<u>1,980,381</u>	<u>44,129</u>	<u>2,024,510</u>
Cash and cash equivalents, end of year	<u><u>\$ 1,994,093</u></u>	<u><u>\$ 54,809</u></u>	<u><u>\$ 2,048,902</u></u>
Reconciliation of operating income to net cash provided by operating activities			
Operating income	\$ -	\$ 2,525	\$ 2,525
Adjustments to reconcile operating income to net cash provided by operating activities:			
Changes in assets and liabilities:			
Deferred revenue	<u>-</u>	<u>7,753</u>	<u>7,753</u>
Net cash provided by operating activities	<u><u>\$ -</u></u>	<u><u>\$ 10,278</u></u>	<u><u>\$ 10,278</u></u>

SINGLE AUDIT SECTION

LifeWays
Schedule of Expenditures of Federal Awards
For the Year Ended September 30, 2004

Federal Grantor/ Pass-through Grantor/ Program Title	CFDA Number	Grant Award (Federal Share)	Federal Expenditures
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES			
Passed-through the Hillsdale County Family Independence Agency			
Title IV-B Subpart 2 Family Preservation and Support Services - Wraparound (WRAP)	93.556	\$ 13,165	\$ 11,494
Passed-through the Michigan Department of Community Health			
Projects for Assistance in Transition from Homelessness (PATH)	93.150	28,960	27,354
Omnibus Budget Reconciliation Act - Preadmission Screenings and Annual Resident Reviews (OBRA-PASARR)	93.778	215,422	161,567
Consumer Cooperative for CMS	93.779	241,895	200,428
Block Grants for Community Mental Health Services:	93.958		
Enhance Outpatient Co-Occurring Disorders Program		40,000	39,999
Enhance Adult Jail Diversion Program		65,410	65,410
SEARCH		70,151	70,151
Juvenile Justice Diversion		40,000	20,559
Wraparound Services		57,416	57,416
Anti-Stigma		31,875	31,875
Drop-In Program Enhancement		14,000	14,000
Drop-In Microenterprise Initiative		58,300	58,300
SED Respite Services		14,336	14,336
TOTAL EXPENDITURES OF FEDERAL AWARDS			\$ 772,889

LifeWays

Notes to Schedule of Expenditures of Federal Awards

1. BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of LifeWays and is presented on the accrual basis of accounting.

The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements.

* * * * *



REHMANN ROBSON

Certified Public Accountants

A member of THE REHMANN GROUP

An Independent Member of Baker Tilly International

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE
AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

December 17, 2004

The Board of Directors
LifeWays
Jackson, Michigan

We have audited the financial statements of the business-type activities, the major fund, and the aggregate remaining fund information of *LifeWays* as of and for the year ended September 30, 2004, which collectively comprise LifeWays' basic financial statements as listed in the table of contents, and have issued our report thereon dated December 17, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether LifeWays' basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered LifeWays' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be a material weakness. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the LifeWays Board, management, others in the organization, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rehmann Johnson



REHMANN ROBSON

Certified Public Accountants

A member of THE REHMANN GROUP

An Independent Member of Baker Tilly International

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH
REQUIREMENTS APPLICABLE TO A MAJOR PROGRAM
AND INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

December 17, 2004

The Board of Directors
LifeWays
Jackson, Michigan

Compliance

We have audited the compliance of *LifeWays* with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended September 30, 2004. LifeWays' major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of LifeWays' management. Our responsibility is to express an opinion on LifeWays' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about LifeWays' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on LifeWays' compliance with those requirements.

In our opinion, LifeWays complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended September 30, 2004.

Internal Control Over Compliance

The management of LifeWays is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered LifeWays' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the LifeWays Board, management, others in the organization, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



LifeWays

Schedule of Findings and Questioned Costs

For the Year Ended September 30, 2004

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

Material weakness(es) identified? ☐ yes ☒ no

Reportable condition(s) identified
not considered to be material weaknesses? ☐ yes ☒ none reported

Noncompliance material to financial statements
noted? ☐ yes ☒ no

Federal Awards

Internal Control over major programs:

Material weakness(es) identified? ☐ yes ☒ no

Reportable condition(s) identified
not considered to be material weaknesses? ☐ yes ☒ none reported

Type of auditors' report issued on compliance
for major programs: Unqualified

Any audit findings disclosed that are required
to be reported in accordance with
Circular A-133, Section 510(a)? ☐ yes ☒ no

LifeWays

Schedule of Findings and Questioned Costs (Concluded)

For the Year Ended September 30, 2004

SECTION I - SUMMARY OF AUDITORS' RESULTS (Concluded)

Identification of major program:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
93.958	Block Grants for Community Mental Health Services

Dollar threshold used to distinguish between Type A and Type B programs:	<u>\$300,000</u>
--	------------------

Auditee qualified as low-risk auditee?	<u> X </u> yes <u> </u> no
--	-----------------------------------

SECTION II – FINANCIAL STATEMENT FINDINGS

None.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None.

SECTION IV – PRIOR YEAR FINDINGS

The single reportable condition noted in the prior year was resolved to the auditors' satisfaction.

* * * * *



REHMANN ROBSON

Certified Public Accountants

A member of THE REHMANN GROUP

An Independent Member of Baker Tilly International

December 17, 2004

Board of Directors
LifeWays
Jackson, Michigan

We have audited the financial statements of *LifeWays* for the year ended September 30, 2004 and have issued our report thereon dated December 17, 2004. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under Generally Accepted Auditing Standards

As stated in our engagement letter dated October 4, 2004, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with generally accepted accounting principles. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is a risk that material errors, fraud, or other illegal acts may exist and not be detected by us.

As part of our audit, we considered the internal control of LifeWays. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we advised management about the appropriateness of accounting policies and their application. The significant accounting policies used by LifeWays are described in Note 1 to the basic financial statements.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Management's estimate of the liability for claims incurred but not reported. We evaluated the key factors and assumptions used to develop the amount of the liability in determining that it is reasonable in relation to the financial statements taken as a whole.

- Management's estimate of the useful lives of its capital assets. We evaluated the key factors and assumptions used to develop the useful lives of those assets in determining that it is reasonable in relation to the financial statements taken as a whole.
- Management's estimate of its maximum risk exposure under its contract with MDCH. This estimate is the basis for determining whether the amount in the risk reserve internal service fund is within allowable limits. We evaluated the key factors and assumptions used to develop LifeWays' Risk Management Plan in determining that it is reasonable in relation to the financial statements taken as a whole.

Significant Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on LifeWays' financial reporting process (that is, cause future financial statements to be materially misstated). We proposed several adjustments related to the proper accounting for various transactions. These proposed adjustments were all recorded by LifeWays, and in our judgment, in the aggregate, had a significant effect on LifeWays' financial reporting process.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to LifeWays' financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, professional standards require the consulting accountant to confer with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as LifeWays' auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no difficulties in dealing with management in performing our audit.

This information is intended for the use of the LifeWays Board, management, others in the organization, and the state and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

A handwritten signature in cursive script, reading "Lehmann Lohman". The signature is written in dark ink and is positioned below the "Very truly yours," text.

LifeWays
Comments and Recommendations
For the Year Ended September 30, 2004

During our audit we became aware of certain matters that are opportunities for strengthening internal control and operating efficiency. This memorandum summarizes our comments and recommendations regarding those matters. A separate report dated December 17, 2004, contains our report on reportable conditions in LifeWays' internal control structure. This memorandum does not affect our report dated December 17, 2004, on the basic financial statements of LifeWays.

We will review the status of these comments during our next audit engagement. We have already discussed these matters with management and we will be pleased to discuss them in further detail at your convenience, or to provide assistance in implementing the recommendations.

Rental Revenue

LifeWays currently leases the space for its offices from a private company, and sub-leases much of that space to its provider organizations. Collection efforts on these sub-leases have varied over the years, and have contributed to the creation of substantial accounts receivable for unpaid rent. In certain prior years, LifeWays has abated a portion of the contractual lease obligation of these providers, as funding permitted. Combined with LifeWays' limited collection efforts, this has caused certain providers to become inconsistent in the payment of their lease obligations.

In light of the significant amount of uncollected rent that had to be written-off in the current year, we recommend that LifeWays recast its collection efforts for past due rent. Since LifeWays is providing a significant sum to its providers on a monthly basis for services provided, there is a built-in opportunity to enforce collection of the leases receivable, by withholding a portion of the payments to the providers equal to their monthly rent.

* * * * *